

California Agricultural Export Training Certificate (CalAgX) Executive Series 2009

Session III: Banking & Finance

*California Centers for International Trade Development (CITD)
in cooperation with the California Department of Food and Agriculture*



Session Three Overview

- Getting Paid: Balancing the risk between seller and buyer
- Types of payment methods
- In-depth review of *Letters of Credit*
- Export credit management and insurance
- Export financing programs
- Duty Drawback
- Foreign exchange risk

Payment Method & Risk

- Choosing your payment method requires finding the right balance between seller and buyer risks as well as total cost
- U.S. companies generally don't offer the 90-day open account terms requested by foreign buyers – which may also mean loss of potential sales
- Learning about payment methods and risk reduction strategies can make a company more competitive

Payment Risks

Low Risk

RISK TO SELLER

High Risk

Cash in Advance / Letter of Credit / Collections / Open Account

High Risk

RISK TO BUYER

Low Risk

Payment Terms:

Cash in Advance /Prepayment

- Cash in Advance: requires buyer to prepay invoice prior to seller shipping
 - Risk to seller: none
 - Risk to buyer: very high; relies on seller to ship
 - Buyer Receives Goods: after payment
 - Cost: low, not related to value of transaction
- **Creative use:**
 - Combine Cash in Advance deposit with Open Account.
 - Credit card

Payment Terms:

Letters of Credit

- Confirmed Irrevocable Letter of Credit: bank guarantee to pay if seller fulfills obligations
 - Risk to seller: Little to none
 - Risk to buyer: Little to none, but may tie up cash
 - Buyer Receives Goods: Generally after payment
 - Cost: Can be high, related to value of transaction
- **Creative use**: Time Letter of Credit

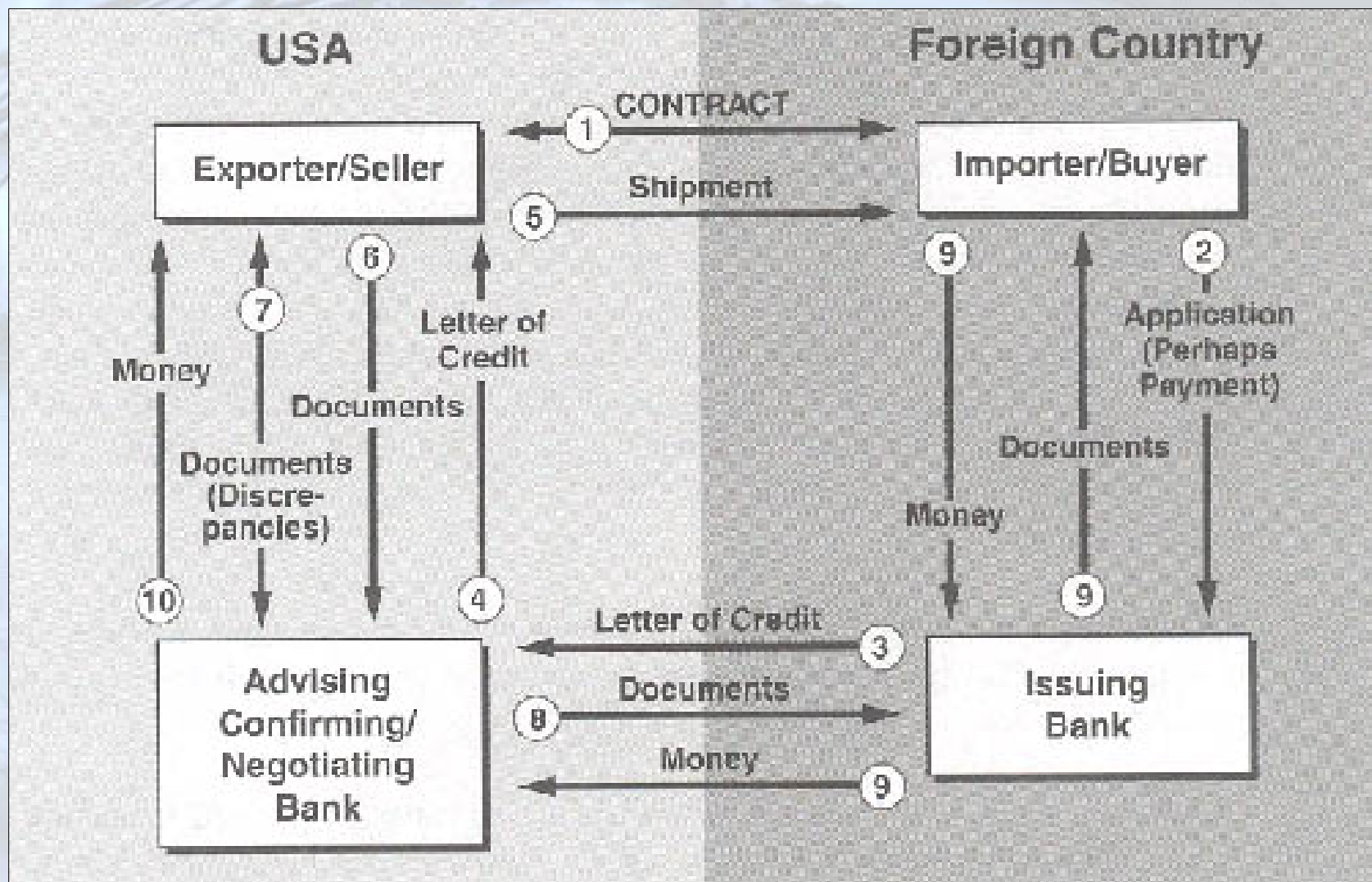
Letter of Credit Terminology

- **Applicant:** the foreign buyer
- **Beneficiary:** the seller
- **Foreign Bank:** bank which opens the L/C (could be a U.S. bank's foreign branch)
- **Advising Bank:** the bank (generally U.S.) that verifies that the L/C is authentic
- **Confirming Bank:** the bank (generally U.S.) that adds its own guarantee to pay
- **Discrepancies:** problems with the paperwork submitted for payment which leads to payment delays and extra costs

L/Cs Come in Different Forms

- Most common:
 - Confirmed, irrevocable, drawn on a U.S. bank, payable in US dollars
 - **Confirmed:** a U.S. bank adds its guarantee to pay assuming terms of the L/C are met
 - **Irrevocable:** can not be changed or cancelled without permission of the seller
 - **Drawn on a U.S. bank:** payment will be available to seller through a U.S. bank
 - **Payable in US dollars:** avoids foreign exchange issues

Letter of Credit: How it Works



Class Exercise 1

When You Get an L/C – Read it Carefully!

- Refer to the Sample L/C and Determine the following:
 - Latest date of shipment?
 - Who pays U.S. bank fees?
 - Can shipment be split into more than one?
 - What documents must the Seller present to the bank for payment?
 - Is the L/C payable upon presentation of documents or at a later date?

Common Discrepancies

- Documents not presented within days allowed
- Bill of lading not consigned as called for in L/C
- Description of mdse not consistent with L/C
- L/C expired
- Invoice not signed
- Additional mdse shipped not called for in L/C
- Invoice not made out in the name of the applicant

Instructions to Your Buyers

- Refer to the second page of the L/C sample
- Check with your bank for their suggested wording when requesting a buyer to open a L/C
- Also discuss adding bank confirmation to the L/C

Payment Terms:

Collections

- Payment method in which a draft (payment request) is sent to buyer for either payment before release of goods (sight draft) or after specified time (time draft)
- Also known as: Documentary Collection, Documents Against Payment D/P (*sight draft*), Documents Against Acceptance D/A (*time draft*)
- Documents Against Payment (D/P) would mean bank holds documents until payment is made by buyer

Payment Terms:

Collections

- Documents Against Payment : requires buyer to pay invoice prior to receiving documents (shipment)
 - Risk to seller: potentially high if foreign bank is unreliable
 - Risk to buyer: similar to L/C
 - Buyer Receives Goods: after fulfilling payment terms
 - Cost: low, not related to value of transaction

Caution: Bank Role is Limited

- In documentary collection, banks are not making a commitment to pay the seller – only that they will act in a ‘good faith’ capacity and make every effort that payment is received. They are only liable for the correct execution of the collection instructions.
- This is a very different role than a confirming bank and a *Letter of Credit*

Payment Terms:

Open Account

- Under Open Account, seller gives credit to the buyer, generally within an overall credit limit
- Buyers often demand Open Account as leverage to increase purchases
- U.S. companies in their initial international expansion tend to not offer credit, which may put them in a competitive disadvantage

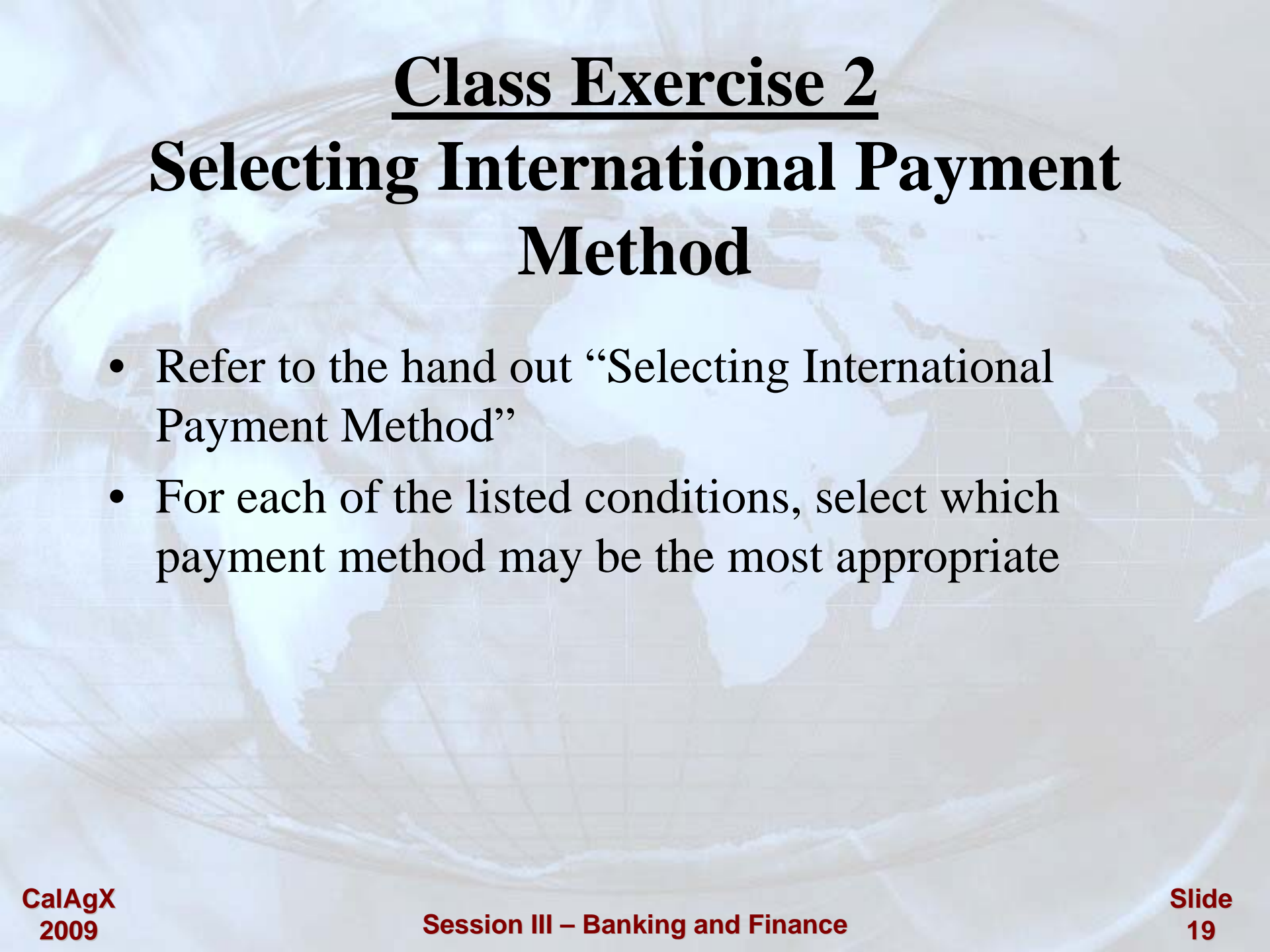
Payment Terms:

Open Account

- Open Account : allows shipment of product with no prepayment or deposit by the buyer
 - Risk to seller: potentially high
 - Risk to buyer: little to none
 - Buyer Receives Goods: immediately
 - Cost: low, not related to value of transaction
- **Creative Use**: good credit management combined with foreign receivables insurance

Good Export Credit Management

- Work with your accounting/financial staff to develop an effective export credit management policy
- Obtain credit reports on foreign buyers:
 - International Company Profile (ICP) – US Dept. of Commerce, US & Foreign Commercial Service
 - Private Sources: Veritas, Dun & Bradstreet
- Establish credit limits based on credit reports, payment history, financials, sales volume, etc.
- Ask for references of other US companies they purchase from



Class Exercise 2

Selecting International Payment Method

- Refer to the hand out “Selecting International Payment Method”
- For each of the listed conditions, select which payment method may be the most appropriate

Foreign Receivables Insurance

- Offers the ability to eliminate most foreign accounts receivable risk by obtaining insurance against that risk (political and commercial)
- Ex-Im Bank: leading provider of insurance for U.S. companies with at least 50% U.S. content
- Private Companies Offering Insurance:
 - Foreign Credit Insurance Agency, Euler American Credit Indemnity, COFACE, etc.

Financing Your Export Growth

- As sales grow internationally, companies may need increased financing to support the growth
- Banks may view foreign expansion and assets (receivables) as higher risk
- U.S. government actively assists U.S. companies expand internationally through financing programs specifically aimed at exporters

U.S. Ag-related Financing Programs

- Foreign Agricultural Service (FAS) Export Credit Guarantee Program (GSM-102 and GSM-103)
 - Provides Credit Guarantees on export sales of selected products for up to three years (GSM 102)
 - Credit Guarantees up to ten years (GSM 103)
- Facility Guarantee Program (FGP)
 - Provides payment guarantees to facilitate the financing of manufactured goods and services exported from the United States to improve or establish agriculture-related facilities in emerging markets

Non Ag-related Financing Programs

- Small Business Administration (and Ex-Im Bank)
Export Express & Export Working Capital
Program
- Overseas Private Investment Corporation (OPIC)
– export loan guarantees including for foreign
assets

Duty Drawback

- Duty Drawback is available in any instance in which an import duty has been paid and goods are eventually exported. You need not have paid the import duty directly, nor acted as the exporter.
- Manufacturing Drawback – Refund on duty paid on imported ingredients to a product that is later exported.
- Same Condition Drawback – Refund on duty paid on “re-exported” products

Claiming duty drawback can be complicated, and it's best to work with customs broker or freight forwarder with experience in the field

Foreign Exchange Risk

- International sales between two countries with different currencies probably contains foreign exchange risk (transaction risk)
- U.S. companies that invoice in U.S. dollars, are pushing the foreign exchange risk onto their buyers
- Though U.S. dollar-based pricing is commonly accepted, companies may consider hedging tools to be more competitive

Forward Contract / Foreign Currency Futures

- Common foreign exchange hedging tools
- Locks in a specific exchange rate (forward rate) for a specific amount of money, for a specific date

CLASS EXERCISE 3

Foreign Exchange Summary

- Most U.S. companies invoice in U.S. dollars and can remain competitive
- Remember that a dollar-based pricing policy probably pushes foreign exchange risk onto the buyer
- As a company grows, some use of foreign exchange hedging tools may be helpful
- To begin, payment in U.S. Dollars is preferable

Session III Wrap-up

- Getting Paid – a balance of risk vs. “making the sale”
- Make sure L/C & all other documents in order
- Credit guarantees / insurance reduce the risk
- Federal programs are valuable tools – use them when appropriate
- Mitigate foreign exchange risk: sell in U.S. dollars or hedge your risk



Questions?